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EUR FOR DAS BRYZA, EUR/NCE FOR MARC NORDBERG

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SUBJECT: HUNGARIAN ENERGY CONSULTATIONS WITH DAS BRYZA,
APRIL 2008

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D).

11. (C) SUMMARY AND ACTION REQUEST: EUR DAS Matthew Bryza visited Budapest on April 7-8 for energy discussions with the GOH, opposition leaders and Hungarian energy company MOL. While the GOH recently signed an agreement with Russia on Gazprom's South Stream pipeline project, the government also has appointed a Nabucco Ambassador. Discussion with MOL revealed a seeming focus on Gazprom-linked projects, despite earlier pro-diversification rhetoric. The FM called for regular consultations with the USG, beginning with discussion of Russia policy, to foster an open dialogue free of "stereotypes." Embassy supports the FM's proposal and requests Department's authorization to move forward as soon as possible. END SUMMARY AND ACTION REQUEST.

FM CALLS FOR REGULAR CONSULTATIONS

12. (C) Opening with a brief recap of the Bucharest Summit, FM Goncz noted her appreciation for the USG's active efforts to resolve the Macedonia name dispute and emphasized her view that continued delay could destabilize the region. She also underscored the importance of NATO's "clear promise" to Georgia and Ukraine, expressing her happiness that the Alliance had avoided a split which would have "sent the wrong message to Moscow." She concluded that Ukraine would now have to focus on building public support for NATO membership, an effort with which Hungary would be "happy to help."

13. (C) Turning to energy issues, FM Goncz appealed for a "consultation structure" to ensure that our bilateral communication did not devolve to "stereotypes." She introduced Nabucco Ambassador-nominee Mihaly Bayer (due for his parliamentary hearing the following day), commenting that his appointment and his contacts throughout the region could add value to international efforts to promote the Nabucco project.

14. (C) DAS Bryza reviewed his recent contacts with Azeri officials, highlighting President Aliyev's positive impressions of his recent visit to Hungary. Turkmenistan is working to make clear that it has the capacity and the political will to move forward, most particularly in resolving their long-standing impasse with Turkey over transit fees. We have worked to encourage engagement at the highest levels, and Aliyev had advised us that he expects resolution "soon -- perhaps within weeks." Based on recent trilateral talks with Turkey and Iraq, we believe Iraq could

begin exporting gas from existing fields to Syria, and then northward, within two years and that significant exports could begin by 2015. However, we prefer the Turkish proposal to export that gas directly to Turkey, via the right-of-way of the existing Kirkuk-Yurmutalik oil pipeline.

15. (C) There is also encouraging news from Turkmenistan, with BP officials projecting that fields there could rival Shah Deniz. Although Turkmenistan has had "hot and cold" relations with Azerbaijan and "a bumpy road" with the U.S., we believe we are now making progress. FM Goncz and Ambassador-designate Bayer remarked that Hungary would support these efforts in contacts throughout the region, hoping that they could find a niche despite - or perhaps because of - Hungary's "smaller footprint."

16. (C) DAS Bryza noted the importance of instilling confidence among Caspian suppliers, highlighting President Aliyev's "confusion" over Hungary's commitment to South Stream. "Sequencing matters," he concluded, "as does the political will" to stay the course on Nabucco in order to avoid efforts to "divide and distract us." FM Goncz responded that Nabucco and South Stream are not mutually exclusive options in Hungary's view, underscoring that projected European demand would require multiple pipelines. South Stream would transit through Hungary, she noted, but that alone would not increase Hungary's dependency on Russia.

17. (C) DAS Bryza agreed that there could be "space and time for both projects" but cautioned that "our intentions and Russia's may differ in this regard." Russia's goal may be to manipulate prices and stifle competition, not to diversify options. FM Goncz replied that Moscow might follow its own interest in preventing progress on Nabucco but noted "that does not mean we have to follow it." She expressed frustration with the EU struggle to form a common energy policy and argued that Hungary should not become "a scapegoat" for doing what other European countries had done. She underscored that perceived U.S. criticism on this front could be "misused politically" in the current climate in Hungary, noting that even granting interviews to certain publications would "in itself be seen as the message."

18. (C) DAS Bryza acknowledged the importance of sending the right signals, warning again that South Stream should not be allowed to "delay and distract us." FM Goncz reiterated her commitment to Nabucco, describing Hungary's South Stream agreement as "only a framework" and noting that "we will work only on Nabucco -- because Gazprom is working on South Stream and needs no encouragement." "Russia is a different kind of regime," she concluded, "but the EU and partner nations need pressure on Nabucco."

MOL SETS SIGHTS ON HUNGARIAN GAS HUB

19. (C) In a meeting with CEO Zsolt Hernadi, International Affairs Advisor Reka Szemerkenyi and the company's gas trading expert, MOL executives denied any involvement in South Stream or Blue Stream II, discussed Gazprom's Baumgarten (Austria) presence at length and presented a north-south pipeline network intended to position Hungary as a regional gas hub, second only to Baumgarten.

110. (C) Hernadi stated up front that he had met Gazprom's Alexei Miller in Moscow on April 1 but gave no details of the meeting, insisting that "MOL has no role in South Stream or Blue Stream II." When asked about MOL-Gazprom joint venture SEP Co., which will do the feasibility study for South Stream, Hernadi looked uncomfortable, saying only that he "told Miller MOL would help with the study, but no study exists." (Comment: This conflicts with what Finance Minister Veres tells us regarding SEP Co.'s efforts, and Hernadi appeared to be intentionally misleading. MOL and the GOH have been equally non-transparent regarding the players in Hungary's South Stream deal. Recent press articles have revealed MOL-Gazprom cooperation on gas storage, allegedly linked to the South Stream pipeline. End Comment.)

111. (C) Despite MOL's alleged exclusion from the South Stream

deal, Hernadi defended the GOH position, calling the inter-governmental agreement (IGA) "not as bad as everyone says." Hernadi confessed that he "cannot say South Stream was a negative decision" in light of Azerbaijani President Ilham Aliyev's caution "about the amounts he could supply ... ever," as well as the likelihood that Gazprom would continue to placate Turkmenistan with rising purchase prices and free rein to sell gas to the east. He also defended the pipeline's economics, arguing that in addition to giving Gazprom a strategic advantage vis-a-vis Nabucco, the project will prevent losses upwards of USD 2 billion per year resulting from alleged Ukrainian siphoning. "For that amount, Gazprom can finance South Stream."

¶12. (C) Looking to the region, Hernadi surmised that Russia is continuing South Stream negotiations in Croatia, using the talks as leverage with Zagreb, and also as insurance against "risky" Hungary. In the broader view, Hernadi remarked that now "Italy is the strategic partner to Russia" and "Germany is not as much of a strategic partner as under Schroeder." (Note: Schroeder visited Hungary April 10-11, broadly criticizing U.S. policy and commending the GOH's decision on South Stream. End Note.)

¶13. (C) Turning to Gazprom's participation in OMV's Baumgarten trading facility, MOL executives explained that Baumgarten is important to Russia because it allows Gazprom to see the entire European market and to use that information to profit from, and close the gap on, existing arbitrage opportunities. Centrex, a Cypriot offshore controlled by Gazprom, currently accounts for 60 percent of Baumgarten trading. In addition, Gazprom will be able to use its newly gained influence over capacity booking decisions to prevent market-based pricing from reaching further into Central and Eastern Europe. Gazprom also will sell gas directly to Baumgarten to complement its long-term contracts with individual countries. Musing on what would happen if Nabucco gas got to Baumgarten, MOL's gas trading director remarked, "then maybe there would be a real market."

¶14. (C) In closing, Hernadi outlined a plan for pipeline interconnectors between Hungary and Croatia and Hungary and Romania, which he described as separate from MOL's NETS (New European Transmission System) proposal. In Hernadi's vision, "MOL becomes a local hub, which is good for MOL and Russia because Russia doesn't want to rely only on Baumgarten." Both Romania and Croatia, he explained, have been cut out of South Stream and, if Nabucco fails, will be completely cut off from major gas pipelines, so "interconnections are vital." With MOL's proposal, each country would contract with Gazprom for gas, and MOL would collect transit fees. Once Croatia has LNG, remarked Hernadi, flows could be reversed to Slovakia, Baumgarten and Romania. (Comment: Post notes that at least in this scenario, MOL stands to gain most if the Nabucco project fails. Despite Hernadi's insistence that this project is separate from NETS, we fail to see major distinctions. In addition, MOL has requested USG support for this project but has yet to provide information on NETS promised in January of this year. Post would urge a cautious approach, since MOL's current plan will only deepen the region's dependence on Gazprom. End Comment.)

FIDESZ SAYS IT REMAINS COMMITTED TO NABUCCO

¶15. (C) At a breakfast with senior officials of the opposition FIDESZ party, DAS Bryza emphasized the importance of "winning the domestic political battles in Hungary" and "making the economic case for Nabucco throughout Europe." He reviewed progress with Azerbaijan, Turkmenistan, and Iraq, emphasizing the importance of "synchronizing investments" to "make Nabucco a reality and not a self-denying prophecy."

¶16. (C) FIDESZ representatives expressed strong agreement with his premise and strong support for his points. Parliamentary Faction Leader Tibor Navracsics expressed concern regarding Russia's success in using both "a soft approach and scare tactics" against Europe. He cautioned that Hungary's current political straits could "inflict many casualties," among them plans to form a Nabucco Committee in

Parliament to support the project. He and Parliamentary Foreign Affairs Committee Chair Zsolt Nemeth underscored their willingness to work with the SzDSz party to adopt a resolution in Parliament "tomorrow," but reiterated their previous reservations re working with SzDSz Party President Janos Koka, commenting that "his party has financial interests in business as usual as well."

¶17. (C) Nemeth also highlighted concerns regarding Russia's "genius for division," noting their success in "dividing Central Asia from Europe -- and Nabucco participants from each other." Although he took DAS Bryza's point regarding the signal success of securing NATO's commitment to Alliance membership for both Georgia and Ukraine at the Bucharest Summit, Nemeth cited a legitimate fear of "abandonment by Europe" throughout Central Asia. Navracsics noted that the GOH's ambiguous position at Bucharest had been the latest blow to Hungary's international credibility.

¶18. (C) FIDESZ is committed to pressing on, however. Legal expert Eniko Csontos reviewed the potential "landmines" in the GOH's recent South Stream agreement, noting that it:

-- Potentially violated EU legislation in providing a VAT exemption for the project;

-- Raised competition concerns in its use of the Hungarian Investment Bank in a joint venture; and,

-- Gives exclusive rights to Russia in determining use and Third Party access.

¶19. (C) Nemeth and foreign policy commentator Anita Orban continued, highlighting the "ridiculous procedure" by which the government had withheld the agreement from Parliament. We do not know "the extent of the state's role" or "the limits on Russia's power," Nemeth concluded, signaling the opposition's intention to continue challenging the South Stream agreement. Turning his attention to Brussels, he called on the EU to "stop apologizing and stand up in the name of simple reciprocity." Orban framed the strategic stakes in stark but plausible terms, suggesting that the GOH will move to cede effective control of its gas transport and power generation infrastructure to Russia. After that, she concluded, "we can talk all we want about Nabucco."

IN THE SHADOW OF A "BIG BEAR"

¶20. (C) While Hungarian Democratic Forum (MDF) Party President Ibolya David was careful to point out that Russia's large reserves mean it cannot be excluded from Europe's energy mix, she asserted MDF's desire for "tools to strengthen competitive capital." Although MDF sees Nabucco as its priority project, David worried that it is a "distant solution" and said she would be pleased to see U.S. assistance in creating "a concrete counter to the Russian monopoly." Bemoaning the EU's failure to "create unity in an area where it has the biggest interests," David said she favors the creation of a common European energy policy and called that strategic vacuum "the reason Gazprom found us unprepared as to how to say 'no'" to South Stream.

¶21. (C) Commenting further on Hungary's decision to sign a South Stream IGA, David said MDF didn't oppose the decision -- because it is to Hungary's advantage to be a transit country -- but admitted that her party had not been happy about "having to say 'ok.'" In the aftermath, she said, MDF pushed the GOH to "appoint a Nabucco Ambassador and work closely with U.S. allies." Underlining her party's commitment to Nabucco -- in response to DAS Bryza's presentation of the pipeline's cost benefits in comparison with South Stream -- David remarked, "we would choose Nabucco, even for the same price (as South Stream). Hungary would absolutely support Nabucco, if it can be built."

¶22. (C) DAS Bryza and David discussed briefly Bucharest's NATO Summit, with both welcoming the Communique language on future membership for Ukraine and Georgia. David said MDF

"wants to do all possible to support Ukraine's NATO membership" but noted how important it will be for Ukraine's public also to support it. Recalling Hungary's own accession, she said public opinion turned in favor of membership after U.S. soldiers mingled with Hungarians in schools, shops and other public venues and invited locals into their barracks for tours. From David's perspective, a similar approach could bring dividends in Ukraine.

TIME FOR HUNGARY TO PUT A LITTLE "GIVE" IN "GIVE AND TAKE"

¶23. (C) COMMENT: The attitudes expressed last week reflect a continuing trend of pragmatism in Hungary's energy strategy. For the opposition, it is a matter of conviction but also a weapon of convenience in the deepening domestic political rift. In a subsequent meeting, FIDESZ President Viktor Orban admitted that his party's legal arguments against Nabucco had been intended primarily to undermine the government's position and that he took a cynical view as to the merits of those arguments. He described Hungary's South Stream IGA as a "contract with a lion."

¶24. (C) For the government and MOL it is a chance to profit from the inevitable in their minds, return of the "big bear. Over the past two years, we have focused on positive outreach to the GH and OL, offering assistance wherever possible and rarely refusing requests. However, with the GOH concerned more with Moscow's reaction than with Brussels' or our, and with MO promoting a pro-centric projects over Nabucco -- despite careful manipulation of the facts for U.S. audiences -- the time has come for Hungary to hold up its end of the bargain, to show that its commitment to diversification goes beyond empty rhetoric. In our view, Hungary should show its good faith by:

-- Following Sofia's example and signing a gas contract with Azerbaijan, even for a token amount;

-- Hosting the Second Annual Nabucco Conference, as a follow-on to the successful September 2007 event (an idea to which the MFA is receptive); and

-- Declaring Nabucco the priority pipeline project in Hungary, establishing a Parliamentary Committee to aid in moving the project forward.

¶25. (C) The regularly scheduled consultations called for by the FM offer an opportunity to engage Hungary on a broad range of issues, reasserting our influence on ground the GOR has maneuvered to monopolize. However, at least on energy security, MOL and the GOH have used their unfettered access to rationalize their decisions rather than to coordinate their policy. We believe their requests for assistance should be viewed cautiously until they put a little more "give" in the "give and take." End Comment.

¶26. (U) EUR DAS Matthew Bryza cleared this cable.
FOLEY